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UNCLAS SECTION 01 OF 02 BRASILIA 002860

SIPDIS

SENSITIVE

NSC FOR RENIGAR, SHANNON
TREASURY FOR OASIA - DAS LEE AND FPARODI
STATE PASS TO FED BOARD OF GOVERNORS FOR ROBITAILLE
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SUBJECT: BRAZIL NATIONAL DEVELOPMENT BANK HEAD DISMISSED

REF: A) BRASILIA 2763 B) BRASILIA 2802

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1. (SBU) Summary: President Lula accepted the resignation of National Social and Economic Development Bank (BNDES) head Carlos Lessa November 18, replacing him with Planning and Budget Minister Guido Mantega. Lessa, a leftist economics professor with longstanding ties to Lula and the Workers' Party (PT), had been a thorn in the administration's side, frequently criticizing administration policies, Finance Minister Palocci and Central Bank Chairman Meirelles. While the financial community will celebrate Lessa's departure, he leaves BNDES a demoralized and diminished institution. Mantega will face significant challenges in rebuilding BNDES, an institution with an annual budget of over \$12 billion. Names floated in the press to replace Mantega at the Planning Ministry include Integration Minister Ciro Gomes and Federal Deputy Paulo Bernardo. The episode highlights the extent to which Palocci's policy line has won the day with the GoB. End Summary.

2. (SBU) Lessa's replacement by Mantega is the second cabinet change in two weeks (DefMin Viegas was replaced by Vice President Alencar on November 8), and it may be followed by further cabinet changes in the coming weeks. Planning Minister Mantega has been named to replace Lessa at BNDES; Mantega's replacement has not yet been named. A few other positions are in play, but depend to great extent on the outcome of the PMDB's internal deliberations on whether to stay in the governing coalition (ref B).

Tenure a Disaster

3. (SBU) Lessa's tenure at BNDES has been widely described as a disaster. He argued that BNDES should return to its roots as a "development" bank, financing industrial projects and infrastructure as it had during the heyday of the import-substitution industrialization push. Lessa surprised the GoB with the purchase of a major stake in privatized mining conglomerate CVRD, later justifying the action on the grounds that it was a "strategic" asset over which the state should have some control. To be fair, despite constant talk of a nationalist economic agenda, Lessa did on occasion show a practical bent and, for example, supported a debt-for-equity swap with U.S. energy firm AES that resolved a sore spot in the FDI arena. Nevertheless, Lessa's criticisms of administration policy were constant, including last week when he called Meirelles' Central Bank chairmanship a "nightmare."

4. (SBU) As bad as the insubordination and constant criticism was for the Lula administration, Lessa's tenure was even worse for BNDES itself. He shook up the institution immediately upon his arrival in early 2003, forcing out not only the Bank's senior management but senior technical level staff as well. Many other key staff chose to leave, hollowing out the bank's capabilities. This was reflected in BNDES' performance, failing to loan out all of the resources it had available. When reproached by Lula and asked to speed up BNDES lending operations, Lessa retorted - publicly, through the press -- that BNDES was "not a bakery" to be handing out its product as quickly as possible. Asked about the firing, one Rio-based economist asked us rhetorically, "What took them so long?"

Mantega Faces a Challenge

5. (SBU) Mantega faces a difficult task at BNDES. The bank's best professionals are gone. Those that remain work, according to one contact, in a "cutthroat" atmosphere. Mantega does have the advantage that he has built a productive relationship with the GoB economic team, in particular Palocci, since their ministries work closely on

budget planning and budget execution. The move to BNDES would nominally be a demotion for Mantega, since the position does not carry cabinet rank and reports to Minister of Industry, Development and Foreign Commerce Furlan. Mantega sidestepped the question when asked by the press whether he would be reporting to Furlan.

Comment

16. (SBU) Lessa's defenestration has been widely interpreted as strengthening Palocci's position within the GoB. And, while the episode clearly illustrates Palocci's strength, Lessa and his outbursts had ceased long ago to pose any real threat to Palocci and the GoB economic team. Lula identified himself publicly with the Palocci/Meirelles policy line early on in his administration. Lula has reaffirmed that line at every major economic juncture since. Lessa was, by this point, an outlier, one of the few lone voices of the old PT left wing left crying in the neo-liberal wilderness. That it took so long to remove him speaks more of Lula's loyalty to an old comrade than to Palocci's position, which was already well secured.

CHICOLA